STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street, 23rd Floor
San Francisco, California 94105

Date: January 30, 2006 File No. RH05046584

Subject: Regulations on Workers' Compensation Deposit Requirements

FINAL STATEMENT OF REASONS

UPDATE OF INITIAL STATEMENT OF REASONS AND INFORMATIVE DIGEST

There is no need to update any of the information contained in the Initial Statement of Reasons, or in the Informative Digest, for this matter.

UPDATE OF MATERIAL RELIED UPON

No material other than that presented in the initial statement of reasons has been relied upon by the Department of Insurance.

MANDATE ON LOCAL AGENCIES OR SCHOOL DISTRICTS

The Department has made a determination that adoption, amendment or repeal of the regulation does not impose a mandate on local agencies or school districts. The regulation has nothing to do with local agencies or school districts; it neither requires nor prohibits action on their part.

ALTERNATIVES

The Commissioner has determined that there are no alternatives that would be more effective, or as effective and less burdensome to affected persons, than the proposed regulations.

Insurance Code §§11690 et seq require admitted insurers to make statutory deposits and also set forth a reinsurer's obligation, when reinsuring such business, to identify in a form prescribed by the Commissioner, amounts deposited for credit in the name of each ceding insurer. This regulation is designed to clarify the reinsurer's obligation and the satisfaction of that obligation in the event that the Commissioner draws upon the workers' compensation deposit made by the reinsurer under the reinsurance agreement.

While the Department of Insurance received a number of comments from the public, none of the comments presented a reasonable alternative to the regulation. Likewise, the Department of Insurance believes there is no reasonable alternative. Because no conceivable alternative regulation would be less burdensome to affected persons, the Commissioner proposes this regulation for adoption.

SUMMARY OF AND RESPONSE TO OBJECTIONS OR RECOMMENDATIONS

A verbatim recital of each written and oral comment, objection, and/or recommendation received during the public comment period and the response to each is attached hereto.

Matthew T. Wulf, Attorney Reinsurance Association of America October 18, 2005 Oral Submission.		My name is Matthew Wulf, I'm with the Reinsurance Association of America. And if you read the Notice of Proposed Action, we're the reason we're here today. I appreciate the time to come and address you and this huge crowd that has interest in this issue. The RAA is a trade association in Washington DC, and we represent large property and casualty reinsurers for the most part. Several years ago we opened up our membership to include affiliate members, but we now include members from the broker community, life reinsurers and offshore reinsurers as well in our daily work disseminating information to all of them and representatives of their interests as well. The Department and the RAA has for several years now been discussing the matter of Workers' Compensation Reinsurance Deposits in California in connection with the statutory changes a number of years ago, and the issues are much broader than what are presented in the regulation today, but I'll stick to the narrow point which we're talking about at this hearing. I'm sure Brian and I will continue discussions of the deposits in general and any legislative approaches in the upcoming years, but in terms of the regulation I'd like to just keep it brief,	Certain amendments to Insurance Code §§11690 et seq., which took effect on January 1, 2003, set forth reporting and other requirements regarding reinsurance agreements that cover workers' compensation business. This reporting requirement gives the California Department of Insurance ("Department"), for the first time, in the event of the insolvency of a workers' compensation insurer, the ability to access not only the workers' compensation deposit made by the insolvent insurer, but also the deposit made by a reinsurer to cover that portion of the insurers' obligation that it assumed under the reinsurance contract. The comment suggests that based on the changes in §§11690 et seq. and on the Department's ability to identify and call upon the reinsurer's workers' compensation deposit, certain reinsurers and their association are concerned about a future possibility that they may be subject to two demands on the same funds, if the California Insurance Commissioner calls on an insolvent non-domestic workers' compensation insurers' reinsurer deposit to pay a reinsured California workers' compensation policy claim, while at the same time, the home state receiver orders the reinsurer to pay all of the reinsurance to the insolvent insurer's estate, with no deduction for the California claim payment. The Commissioner has considered this comment and rejects it. This situation has never happened before and probably never will, because payment of the California claim from the workers' compensation deposit would reduce the reinsurers' overall obligation to the estate by that amount. However, to address this possibility, the proposed regulation was drafted to clarify that the deposit obligation and the use of deposited assets remains unchanged, notwithstanding the reinsurance arrangement, and that any use of the reinsurance deposit proceeds to pay specific California workers' compensation claims will result in the satisfaction and release of those claim obligations. To the degree that it helps to achieve this goal, the proposed regulation is reasonably necessary.

		you have our letter. The one point I'd really like to stress is that what we see in the contract requirement in the statute is reinsurers are faced with a situation where according to the credit for reinsurance laws in all the states, they're required in their contracts to have an insolvency clause, and that insolvency clause has a provision for the ceding company receiving credit, requires that the reinsurance pay without diminution into the estate of the insolvent insurer, and that's been around since the thirties, a development out of New York in the Pink case to make sure that the reinsurers pay a hundred cents on the dollar even though the estate may ultimately be paying out something less than that. What the California statute requires is a contract provision which enables the Commissioner in California to direct the proceeds of the reinsurance deposit which is on file in California as a condition for being able to write Workers' Compensation reinsurance business in California, direct that to the guaranty fund to pay claims on Workers' Comp. policies. And what we see the issue is if you're dealing with a California domestic, you've got the Commissioner and the receiver, essentially the same person switching	This portion of the comment references §11691(f)(2) and the requirement that reinsurance contracts contain clauses that grant the Commissioner authority to use workers' compensation deposits to pay claims in the event of an insurer insolvency. The proposed regulation was drafted to clarify the fact that the deposit obligation and the use of deposited assets remains unchanged, regardless of the reinsurance arrangement. Further, any use of the reinsurance deposit proceeds to pay specific California workers' compensation claims will result in the satisfaction and release of those claim obligations. Therefore, to the degree that it helps to achieve this goal, the proposed regulation is reasonably necessary.

		hats; it's not going to be a problem with committing that asset twice, they are going to essentially choose probably the public policy decision at least as articulated by statute to direct that money to the guaranty fund to pay those claims, collect the rest of the assets of the ceding insurer, and distribute them according to the prior distribution. What you're faced with in any other state is the receiver looking at the assets of the ceding insurer, and this reinsurance deposit would be an asset, it would be filed as I understand on Schedule P. I have not actually filled out or filed an annual statement, but I believe that's where it would be located. So the receiver in another state would see this deposit as an asset, and it's possible that that receiver would then require that asset to become part of the estate and then be paid out under that own state laws, and that creates the potential for duplicate liability for the reinsurer where you've got the receiver saying in a state other than California we are going to take this, this asset, this that you have listed as your company, although it's a deposit in California, and then require it to become part of the estate. You've got California saying well, no, according to our statute and	

		according to the contract clause language that deposit goes directly to the guaranty fund to pay Workers' Compensation policy losses. So what we have recommended -- and the regulation that we have before us today came out of these discussions I understand, it was the Department's nod to us in trying to satisfy our concerns and help this problem, and there are two suggestions that we have to it that we feel really are necessary to get to the crux of that duplicate liability issue, and they're outlined in the letter, but essentially they would be two additional sentences. One providing that the Commissioner in California would provide notice to the ceding insurer's domiciliary receiver and to the reinsurers of an intent to draw down on the deposit. And we understand from conversations with the Department that that would be the normal course of action and that this is how they intend to effect this law and that this would just be stating something that is essentially common practice, but it would give our members some comfort that this is actually how the process is supposed to work and codify at least in regulation that the Commissioner is required to give this notice when the reinsurance deposit will be drawn	This portion of the comment suggests two additions to the language of the proposed regulation. The first suggested addition is that prior to making any draw on the deposit, the Commissioner must notify, in writing, the ceding insurer's domiciliary receiver and reinsurers. Insurance Code section 11691(f)(2) currently requires a 30-day notice to the reinsurer that its deposit may be used. Please note that if the reinsurer received that notice and decided to pay disputed claims, then according to the statute, the Commissioner would not access the special deposit because the claims would be paid. Because notice to the affected reinsurer is required under the current statute, additional regulatory language regarding yet another notice requirement is redundant and unnecessary. Thus, including a reinsurer notice requirement would contravene the "necessity" and "nonduplication" standards of Govt. Code section 11349.1. Regarding advance notice to the receiver, the comment does not indicate how such a requirement would "get to the crux of that duplicate liability issue." A receiver who was determined to impose duplicate liability, in violation of law and equity (because California claims would be covered by the deposit, thus relieving the estate largely or completely from responsibility for those claims), presumably would not be deterred by mere receipt of advance notice. As the comment notes, provision of notice is standard practice, as a matter of courtesy. Ultimately, however, the purpose of a regulation is to "implement, interpret, or make specific the law," (Govt. C. section 11342.600]) not to codify conventions of etiquette or to dispense "comfort." The Commissioner's primary duty, and the purpose of the law under which the Commissioner acts, is to protect California workers' compensation employer policyholders and employee claimants by preserving the Commissioner’s ability to access deposits as expeditiously as exigent circumstances might require (See Insurance Code section 11698 (a)). Even if the Commissioner did

		down upon. The second one is intended to indicate that the intent of the regulation is not to create duplicate liability, and the language we have there is just in tracking with the form of the regulation saying the Commissioner shall not use the reinsurer's deposit in a manner that will create duplicate liability for the reinsurer. And again in conversations with other Department staff, we understand that it is not their intent to make the reinsurer pay twice, that the regulation is aimed towards making sure that the payment of any claims with the use of the reinsurance deposit will fully satisfy and release the reinsurer's liability, and that language is already in the regulation. And these two additional amendments that we suggest clarify again that the real crux of the issue for us is that the use of this contract requirement in the statute should not create duplicate liability for the reinsurer, and the way to ensure that is to make sure that everybody's talking to each other with notice, and that the Commissioner understands that the use of that deposit is not intended to create duplicate liability, and that's really the gist of it, that's the basics.	not give notice to a cedent's receiver, the statutorily-notified reinsurer could, and undoubtedly would, do so, to let the receiver know that the reinsurer's payment obligation to the estate had been altered with regard to California claimants. The second suggested addition is that language be inserted into the proposed regulation stating that the Commissioner will not use the reinsurer's deposit in a way that will create duplicate liability. However, the proposed regulation currently states that the reinsurer's deposit is regarded as the same as the ceding insurer's own special deposit, and is not available for use by a foreign state receiver. The comment's suggested language essentially repeats what is already included in the proposed regulation and ignores the regulation's language, which already prohibits duplicate payments. Inclusion of the comment's suggested language, repeating what is already contained in the proposed regulation, could create ambiguity and a speculative claim by reinsurers that, in fact, a duplicate payment will be required. The comment mischaracterizes the purpose and effect of the proposed additional language. The proposed addition is described as a mere innocuous statement of intent not to create duplicate liability. It is not. That intent is already expressed in the regulation's second sentence, which allows use of the deposit only to pay the workers' compensation claim-portion for which the reinsurer is liable. Clearly, payment of that claim-portion from the deposit proceeds would discharge the reinsurer's liability with respect to it. What the proposed additional language would do, by contrast, is prevent CDI from obtaining access to a reinsurer's deposit any time a foreign state receiver raised an objection, no matter how spurious--because then, the reinsurer could claim that it was exposed to the possibility of duplicate liability and so it could defy CDI's payment-order. Whether the proposed amendment's ultimate purpose is to enable reinsurers to delay payment, retain deposits longer and continue to collect interest on them or to give reinsurers a pretext to interplead deposits with a court for

		We've laid out some arguments and some scenarios in the comment letter, those are available to you, I'm sure you've read them, but I think unless -- I'll open it up for questions from you, and I'm sure Mr. Perkins would like to say something as well. We are not aware [of situations where this has come up in the past.] The extra requirement language that has really brought about this concern is relatively new in the last several years, and I believe -- I have to look back in the letter, but I don't think it was required in contracts till 2005, so it was really just the beginning of this year, or for business -- contracts that were written that covered business in 2005, so presumably starting at the end of '04 we started seeing some of this language, so it's a relatively new contract requirement for the reinsurer. So specifically under this statute it has not arisen, and in fact we're not aware of any instance where the California Commissioner has used a reinsurance deposit because they have been required for some time, and a domiciliary receiver has also requested that same, essentially that same reinsurance claim asset, so we are not aware of an actual instance in California under the Workers' Compensation deposit laws.	CDI and the foreign state receiver to fight over, thus washing their own hands of the matter, is uncertain. In either case, the practical effect would be to defeat the statutory intent of having a deposit altogether, by enabling foreign state receivers to exercise a *de facto* veto over any disbursal of deposit proceeds, merely by raising the possibility of dual liability, however unfounded. Opening this door would only encourage foreign state receivers to do just that: initiate negotiations with CDI aimed at letting them pull a little money out of the statutory deposit for their own state, in return for relinquishing their claim against the reinsurer and thus enabling CDI to avert claimant hardship or CIGA burden by obtaining payment from the 'frozen' reinsurance deposit. No such concealed trap that could defeat the statutory deposit's purpose should be slipped into this regulation. The Commissioner has considered the comment and rejects it.

		There have been other instances where reinsurers have been required to pay twice due to inconsistent contract clauses in other states, and that's really what gives our members some concern is that they have seen where courts and regulators have disagreed, and in essence required reinsurers to pay the same asset twice, once to a particular party and once into the estate; very rare but it has happened. As I understand how California would work is that upon the insolvency of that company, the Commissioner would at that point have the ability to draw down the deposit and could do so at any time. I assume then the instance would be ceding insurance becomes insolvent, California Commissioner uses the deposit on file to pay claims, domiciliary receiver then says I see this listed as an asset of the ceding company, therefore, reinsurer, you owe the estate X amount of dollars. What we're hoping would happen under our two amendments is that the receiver and the Commissioner would contact; there would be that notice and there would be that contact, and they would speak and would agree as to the use of it essentially saying, California Commissioner would say to the domiciliary receiver we've got	

		this statute in our state requires that this deposit be used to pay Workers' Compensation reinsurance claims outside of your state of receivership, you know, paid a hundred cents on the dollar; therefore that satisfies and releases the reinsurer's liability on that, and the receiver would then agree, oh, okay, we understand. What we're really trying to avoid here is what I think would be a misunderstanding, and I don't think anyone suspects any Commissioner to with a straight face say, reinsurer, you owe twice. What it really would be would be a misunderstanding, where as you say if the bell has already rung, and then that receiver because they hadn't communicated because there was no notice says well, I'm not concerned with what your state law says, my state law says this and the contract says due to the insolvency clause that everything gets paid to the estate, and I'm going to follow my law.	
Brian Perkins, Staff Director of the Senate Banking, Finance and Insurance Committee. October 18, 2005		Thank you. My name is Brian Perkins and I am the Staff Director of the Senate Banking, Finance and Insurance Committee. I was also staff for Senator Speier with respect to SB 2093 of the year 2002, the bill that is the authority for the Department's proposed regulation. I'm representing Senator Speier	This comment is in support of the regulation as proposed and is not an objection or a recommendation to change the proposed regulation. No further response is necessary.

Oral submission		today. Although I've not had an opportunity to brief her in full about the regulation, I do believe that my comments reflect her perspectives, and I will share my comments with her later this week. Should there be any material differences between our perspectives, we will notify the Department. I do not expect there to be any such differences. I'm here today to encourage the Department to adopt the proposed regulation as proposed. It comes after many months of discussions between industry, the Department and our office. The regulations first authorize -- are authorized and are appropriate because the proposed regulation reflects the legislative intent of SB 2093. The intent of the bill was to ensure that in the event a ceding carrier became insolvent, a reinsurer's deposit for Workers' Compensation would perform in all essential respects, just like the ceding carrier's deposit. It is helpful to remember the origin of the bill. CIGA nearly went broke in 2002, and the legislature permitted a one percentage point increase in assessment levied upon Workers' Compensation premiums. It became apparent that inadequate deposits by ceding carriers were aggravated by the refusal of summary insurers and	

		bond companies to pay the covered claims. This is why the proposed regulation is promulgated in compliance with the law. It reinforces and clarifies the way in which deposits of reinsurers will perform after an insolvency of the ceding carrier. It should also be noted that the proposed regulation clarifies to receivers in other states that California will treat a deposit as if it were a deposit of the ceding carrier; this will avoid the very unlikely scenario that has been put forth by critics of the underlying legislation, that somehow a receiver may be called upon -- excuse me, a reinsurer may be called upon to pay twice. Finally, it should also be noted that a reinsurer's deposit would only be accessed if the reinsurer refused to pay covered claims, and even then only with notice and all rights of the reinsurer are always retained. In short, this regulation is appropriate and carefully crafted to deal with a highly speculative situation in which a reinsurer refuses to pay, and the deposit of the company must be accessed to pay injured California workers. Although summary insurers and issuers of bonds refused to pay in recent insolvencies, the bulk of reinsurers do pay. Thus, while the	

		regulation is helpful to clarify how the Department will act in a rare set of circumstances, it is unlikely that the regulation will be used for that very reason, the circumstances themselves are rare. In sum, the regulation is clearly authorized, it clearly implements legislative intent, and it is the least intrusive method of clarifying the obligations of reinsurers who in the rare event of a refusal to pay, nonetheless owe money to injured workers in California. Before I close, let me also note some of the proposed amendments by the RAA. When I brief Senator Speier later this week, I will advise her that the language that is proposed is probably not in the interests of people of the State of California, nor does it clarify or assist with SB 2093, and let me just get to the heart of the matter. The language that's already been proposed by the Department artfully and appropriately prevents duplicate payment in my judgment. Saying the same thing twice muddies the waters, and when you put in a prohibition as is proposed here that reinsurers not be made to pay twice, you first of all overlook the underlying structure of the proposed regulation which already achieves that objective; and	

		second of all, you give to the reinsurer a reason to make a claim unfounded that in fact a duplicate payment will be required. It's a speculative claim at that point. You, Mr. Holmes, mentioned the situation which the money had already flowed, but even in advance it would be a speculative assertion. The language that the Department proposed on the other hand works well with existing law, and it works well because existing law recognizes that the ceding carrier's own deposit is a special form of deposit and isn't available to a foreign state's receiver. What your proposed regulation does is put the reinsurer's deposit on par and in the same class as a special deposit of the ceding carrier, and that's a wonderful way of doing things, there's no ambiguity then about a double payment. So, making a statement about double payment in fact creates the ambiguity, and I would urge the Department not to do that. Second of all, there's a statement here about prior to making any draw on the deposit, the Commissioner is going to notify in written form the ceding insurer's domiciliary receiver and reinsurers; that too is vague. The statute itself, 2093, already requires 30-day notice to the reinsurer that their deposit may be	

		used. It should be noted that if the reinsurer receives that notice and decides to pay disputed claims, then my understanding the way the law was intended to operate is in fact there wouldn't be any accessing of the deposit, the claims would simply be paid. So, the notice has already been given to the reinsurer who is affected. No doubt the reinsurer would notify the domiciliary individual about that, and trying to create yet another notice opportunity also means that the State giving a foreign court the opportunity of California would at that point be to interfere with the operation of state law in the intent to ensure that injured California workers are paid timely. I just want to reinforce for the purposes of the record the crisis that existed in 2002 and why this particular part of the statute was necessary. CIGA did almost go broke. There was talk at the time of if that happened, employers would have to start paying tens of thousands of claims of injured workers in a chaotic manner, undoubtedly with a lot of mistakes and no doubt with a lot of penalties; in short, a great deal of human tragedy and a lot of disruption to California's economy. As we sit here three years later, it's	

		sometimes difficult to remember that reality, but it's important that deposits perform as deposits are intended to perform. They're intended to be hard cash for a very real obligation, and it would defeat the purposes of the law were these particular amendments adopted into the proposed regulation, and we would urge you therefore to go forth with the good work that you did until this point, and we thank you very much for your consideration and not adopt those particular regulations, proposed amendments.	

Matthew T. Wulf, Attorney Reinsurance Association of America October 12, 2005 Oral Submission.		I won't take much time, but let me just, let me quickly say again, it's Matt Wulf from the Reinsurance Association. And we've had some of these debates, discussions with Mr. Perkins over the years that this statute has been amended and that this regulation has been proposed, and we just don't believe that the regulation as drafted really gets to the heart of that duplicate liability problem. We don't think the amendments are vague or add ambiguity as he said. The statute requires notice to the reinsurer. What we're trying to ensure is communication between the two regulatory entities, between the domiciliary state and California,	The comment suggests that the regulation as drafted does not provide adequate notice to regulatory agencies in the event of an insurer insolvency. The proposed regulation specifies and clarifies a reinsurer's obligation, and the satisfaction of that obligation, in the event that the Commissioner draws upon the workers' compensation deposit made by the reinsurer under the reinsurance agreement. The Commissioner has considered the comment and rejects it. To address the possibility that the California Insurance Commissioner might call on an insolvent non-domestic workers' compensation insurers' reinsurer deposit to pay a reinsured California workers' compensation policy claim, while at the same time, the home state receiver might order the reinsurer to pay all of the reinsurance to the insolvent insurer's estate, with no deduction for the California claim payment., the proposed regulation was drafted to clarify that the deposit obligation and the use of deposited assets *remains unchanged*, notwithstanding the reinsurance arrangement, and that any use of the reinsurance deposit proceeds to pay specific California workers' compensation claims will result in the

		that's what the amendments are designed to encourage. We understand from the Department that that dialogue is natural, that's what happens. We don't see any harm in adding it to the regulation to kind of recognize that this is how these deposits are dealt with in a normal course of business. Thank you.	satisfaction and release of those claim obligations.

Association of California Insurance Companies Written Statement submitted on October 17, 2005		The Association of California Insurance Companies (ACIC) is an association comprised of more than 300 property/casualty insurance companies that are doing business in California. ACIC members are responsible for approximately 43 percent of the private workers' compensation insurance market in California. ACIC is an affiliate of the Property Casualty Insurers Association of America. ACIC is concerned that the provisions in Insurance Code §11691 create the potential for imposing duplicative liability on workers compensation reinsurers. This potential presents an issue for workers compensation insurers that must manage their risk by purchasing reinsurance. We believe that in order to preserve the viability of the workers compensation insurance market, the Legislature needs to reexamine the requirements of §11691. The proposed regulations do not resolve all the concerns about duplicative liability. That resolution must await legislative action. However, the proposed regulations	The written comment, submitted post-hearing, states that based on the changes in §§11690 et seq. and on the CDI's ability to identify and call upon the reinsurer's workers' compensation deposit, certain reinsurers and the ACIC are concerned about a future possibility that they may be subject to two demands on the same funds, if the California Insurance Commissioner calls on an insolvent non-domestic workers' compensation insurers' reinsurer deposit to pay a reinsured California workers' compensation policy claim, while at the same time, the home state receiver orders the reinsurer to pay all of the reinsurance to the insolvent insurer's estate, with no deduction for the California claim payment. The Commissioner has considered this comment and rejects it. This situation has never happened before and probably never will, because payment of the California claim from the workers' compensation deposit would reduce the reinsurers' overall obligation to the estate by that amount. However, to address this possibility, the proposed regulation was drafted to clarify that the deposit obligation and the use of deposited assets remains unchanged, notwithstanding the reinsurance arrangement, and that any use of the reinsurance deposit proceeds to pay specific California workers' compensation claims will result in the satisfaction and release of those claim obligations. To the degree that it helps to achieve this goal, the proposed regulation is reasonably necessary.

		make an effort at providing some clarity. The regulations should be amended so that they more effectively address the issue of duplicative liability. ACIC supports the two amendments put forward in the Reinsurance Association of America's October 12, 2005 letter to the Department of Insurance. The amendments would 1) require notice to a ceding insurer's domiciliary receiver and reinsurers of the insurance commissioner's intent to make any draw on the workers' compensation deposit, and 2) explicitly state that the use of the reinsurer's deposit is not intended to create duplicate liability for the reinsurer.	 See the Commissioner's earlier response to the RAA's specific proposed amendments.

Reinsurance Association of America Written Statement submitted on October 12, 2005		The Reinsurance Association of America ("RAA") looks forward to the opportunity to speak and participate in the hearing on October 18th regarding the proposed new Workers' Compensation Deposit Requirements Regulation. We have reviewed the Department's proposed Workers' Compensation Deposit Requirements Regulation and we appreciate the Department's willingness to address this issue. As discussed herein, the RAA respectfully suggests two amendments that will: 1) require notice to a ceding insurer's domiciliary receiver and reinsurers of the California Commissioner's intent to make any draw on the workers' compensation deposit; and 2) explicitly state that the use of the reinsurer's deposit is not intended to create duplicate liability for the reinsurer. By way of background, the RAA is a national trade association representing property and casualty organizations that specialize in reinsurance. The RAA membership is diverse and includes large and small, broker and direct, U.S. companies and subsidiaries of foreign	Certain amendments to Insurance Code §§11690 et seq., which took effect on January 1, 2003, set forth reporting and other requirements regarding reinsurance agreements that cover workers' compensation business. This reporting requirement gives the California Department of Insurance ("Department"), for the first time, in the event of the insolvency of a workers' compensation insurer, the ability to access not only the workers' compensation deposit made by the insolvent insurer, but also the deposit made by a reinsurer to cover that portion of the insurers' obligation that it assumed under the reinsurance contract. The written comment mirrors the oral submission that the RAA presented at the October 18, 2005, hearing. This comment suggests that based on the changes in §§11690 et seq. and on the Department's ability to identify and call upon the reinsurer's workers' compensation deposit, certain reinsurers and the RAA are concerned about a future possibility that they may be subject to two demands on the same funds, if the California Insurance Commissioner calls on an insolvent non-domestic workers' compensation insurers' reinsurer deposit to pay a reinsured California workers' compensation policy claim, while at the same time, the home state receiver orders the reinsurer to pay all of the reinsurance to the insolvent insurer's estate, with no deduction for the California claim payment. The Commissioner has considered this comment and rejects it. This situation has never happened before and probably never will, because payment of the California claim from the workers' compensation deposit would reduce the reinsurers' overall obligation to the estate by that amount. However, to address this possibility, the proposed regulation was drafted to clarify that the deposit obligation and the use of deposited assets remains unchanged, notwithstanding the reinsurance arrangement, and that any use of the reinsurance deposit proceeds to pay specific

		companies. Together, RAA members write nearly 2/3 of the gross reinsurance coverage provided by U.S. property and casualty reinsurers and affiliates. Our members provide reinsurance capacity that supports the California economy in all lines of business, including workers' compensation. The RAA seeks to amend the workers' compensation deposit regulation to make the California economy more competitive while still providing financial security that supports the state's workers. For the reasons set forth herein, the RAA amendments to the proposed workers' compensation deposit requirements regulation will ease the uncertainty in the workers' compensation market that arises from the reinsurers' potential for duplicate liability for claims payments in the situation of an insurance insolvency. The current California law requires that liabilities flowing from reinsurance contracts be paid to the receiver of the insolvent insurer. A similar provision is required in all 51 US jurisdictions. As a condition of a cedent receiving credit for reinsurance, the reinsurance contract must contain a provision	California workers' compensation claims will result in the satisfaction and release of those claim obligations. To the degree that it helps to achieve this goal, the proposed regulation is reasonably necessary.

		explicitly stating that in the event of the cedent's insolvency, reinsurance claim assets will be paid to the receiver of the insolvent cedent. California law also requires admitted reinsurers to post a deposit in order to write workers' compensation business. While the deposit is dedicated to the payment of workers' compensation claims under California law, it may be considered an asset of the reinsurer. Pursuant to the 2002 amendments to the workers' compensation deposit law that took effect on January 1, 2005, California now requires a provision in all reinsurance contracts that states that the California Insurance Department can draw down the workers' compensation deposit and divert the proceeds to the guaranty fund to pay workers' compensation claims. This statutory and contract mandate is unique to California; nothing like it exists in any other state. The most problematic issue,however, is that California law now mandates the inclusion of two provisions in the reinsurance contract, one that directs payment of the reinsurance contract liability to the receiver, and one that directs payment of substantially the same obligation from the workers' compensation deposit to the guaranty	

		fund. In the case of an insolvent California domestic insurance company, the California Insurance Commissioner appoints the receiver and decides whether the deposits will be paid to the receiver or to the guaranty fund. The Commissioner, in essence, gets a choice of where to direct the reinsurance claims assets. But if the insolvent insurer is not a California company, the receiver of that company is outside of California and subject to that domiciliary state's laws; it is not controlled by California law or the California Insurance Commissioner. Under that scenario, the reinsurer can become the victim of contradictory decisions regarding what should be done with the reinsurance claim assets by two different regulators, both citing statutory and contractual provisions for their authority. In short, the reinsurer is bound by California law to allow the California Insurance Commissioner to pay the guaranty fund from the deposit; but the reinsurer may also be bound by the insolvent insurer's home state law to pay the receiver in that state. This creates an untenable potential for duplicate liability for reinsurers.	

		In the case of non-domestic insolvent insurers, the California Insurance Commissioner can choose to draw down the deposit to pay the guaranty fund for California claims; later, the receiver of the non-California company can demand that all reinsurance claims payments be made to the receiver because the reinsurance is a general asset of the estate to be used for the purpose of satisfying all claims of the estate. The fact that two regulators can demand payment from the reinsurer based on the same claim obligation creates a duplicate liability problem. Since both insurance regulators would be able to cite statutory and contract language governing the payment of the reinsurance asset, if they make independent and contradictory decisions, the reinsurer can be forced to pay the same claim twice. The law of one state cannot override or supercede the laws of other sovereign states. By necessity, the duplicate liability problem can only be resolved by cooperative action of the two state insurance regulators. Clearly the threat of duplicate liability creates a disincentive to reinsurers to provide reinsurance	

		capacity for the California workers' compensation market. Several reinsurers already have informed the California Insurance Department that they have restricted their workers' compensation reinsurance capacity for business written in California. This effect likely will grow as insurers, reinsurers and brokers become more aware of the adverse consequences associated with this contractual requirement. By adding the RAA's suggested amendments to the proposed regulation, however, the Department can aid in preventing this issue from contributing to a future constriction of the California workers' compensation insurance market. It is our understanding that the proposed regulation is intended to clarify the California Insurance Commissioner's use of a reinsurer's workers' compensation deposit. However, the regulation fails to address the crux of the duplicate liability problem. While the RAA continues to believe a statutory amendment is the best means to ensure reinsurers are not subject to duplicate liability under California law, if the proposed regulation is to be effective, it must expressly address the duplicate liability concern	

		through a notice provision and a statement of intent. Only with provisions providing for communication between the California Insurance Commissioner and a ceding insurer's domiciliary receiver and a regulatory recognition of the duplicate liability problem, will the regulation provide sufficient assurance to the market regarding the appropriate use of reinsurer deposits. Accordingly, the RAA recommends the regulation be amended as follows: When an admitted insurer is subject to proceedings specified in 11698(a) or 11698.3, any workers' compensation deposit made pursuant to 11691(f)(1) by any reinsurer of the insurer, which the reinsurer was required to identify to the commissioner pursuant to 11691(f)(1) and for which the ceding insurer was allowed any deposit credit, shall be deemed for the purposes of this Article to be included as part of the ceding insurer's own workers' compensation deposit pursuant to 11691(a). Prior to making any draw on the deposit, the commissioner shall provide written notice of the intent to do so to the ceding insurer's domiciliary receiver and reinsurers. The commissioner shall use the proceeds of any such deposit by the	See the Commissioner's earlier response to the RAA's specific proposed amendments

		reinsurer, and any interest thereon, only for the payment of that portion of a workers' compensation claim which the reinsurer is required to pay as determined pursuant to 11691(f)(2). The Commissioner shall not use the reinsurer's deposit in a manner that will create duplicate liability for the reinsurer. To the extent that any portion of a reinsurer's deposit is used to pay a compensable workers' compensation claim against an insurer as provided in the preceding sentence, the liability of the reinsurer with respect to the portion of the claim so paid shall be deemed fully satisfied and released. Upon request the commissioner shall provide to any reinsurer a special certificate pursuant to 12973 that memorializes the satisfaction and release. Further, by reason of the reinsurance agreement requirements set forth in 11691(f)(2), payment of a claim from a reinsurer's deposit shall be considered an authorized payment to an alternative payee for the purposes of 922.2(a)(2). These proposed amendments would leave in place the statutory requirement that the insurance regulator can divert the reinsurance asset to the guaranty fund but would provide for communication with the	

		state that controls the receivership prior to such a diversion. This conforms with what the department advises is its current process. Further, the amendments attempt to reduce the duplicate liability problem that has created uncertainty in the current market. Thank you for the opportunity to offer comments on this proposed regulation. The RAA will also be present and available to discuss these comments at the hearing on October 18. If you have any questions in the interim or need further information, please contact us.	